UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF MISSOURI

In re:	)	
	)	
FARMLAND INDUSTRIES, INC., et al.,	)	Case No. 02-50557-JWV
	)	
Debtors	)	Joint Administration

MEMORANDUM OPINION AND ORDER

The matter before the Court is the Joint Application for Allowance and Payment of Administrative Expense Claim Pursuant to Section 503(b) of the Bankruptcy Code ("Application") filed by River Barge Partners, L.P. ("River Barge") and The CIT Group/Equipment Financing, Inc. ("CIT"). Farmland Industries, Inc. et al., ("Farmland" or "Debtors"), the debtors and debtors-in-possession in these jointly administered Chapter 11 cases, and the Official Committee of Unsecured Creditors ("Committee") filed objections to the Application. River Barge and CIT filed a response to the Committee's objection. On March 18, 2003, the Court held a hearing on this matter and took the issues under advisement. For the reasons set out herein, the Court will deny the Application.[1]

FACTUAL BACKGROUND

On May 31, 2002, the Debtors filed their separate voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code.[2] Farmland Industries, Inc., the principal debtor, is a farmer-owned cooperative which, in conjunction with some of the debtor subsidiaries and other non-debtor entities, manufactures and markets fertilizer and stores and markets crops, among its many business activities. As a part of its operations, Farmland used barges to transport grain and fertilizer from and to its member cooperatives and farmer-members along the Mississippi River. Farmland and another entity, PINCO, Inc., organized Pinnacle Barge Company, LLC ("Pinnacle") to lease and operate, as a charterer, a fleet of barges primarily intended for Farmland's use. Farmland owns a fifty percent interest in Pinnacle.

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[1] The Court has jurisdiction of this matter pursuant to 28 U.S.C. § 1334. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2). This Memorandum Opinion and Order constitutes the Court's findings of fact and conclusions of law pursuant to Rule 7052 of the Federal Rules of Bankruptcy Procedure.

[2] Title 11, United States Code.

In 1997, Pinnacle entered into various contracts with River Barge to charter 100 hopper vessels. Especially pertinent to the Application, Pinnacle and River Barge entered into a charter agreement on January 24, 1997, under the terms of which River Barge chartered the vessels to Pinnacle for a period of approximately eighteen years in exchange for, among other things, a series of quarterly payments in advance. CIT loaned River Barge approximately $24.6 million to finance River Barge's acquisition of the vessels and holds mortgages on the vessels.

In connection with the charter agreement, Farmland, Pinnacle, River Barge and CIT entered into a Novation Agreement also executed on January 24, 1997. The Novation Agreement provides that, upon the occurrence of one or more specified "novation events," Farmland would be deemed to be bound by the terms of an automatically created new charter agreement for the vessels between River Barge and Farmland, thereby supplanting the original charter agreement between River Barge and Pinnacle.

On August 9, 2002, River Barge, with the consent of CIT, filed a motion with this Court to lift the automatic stay in Farmland's case so that River Barge could repossess the vessels from Pinnacle. Neither Farmland nor the Committee objected to that Motion. On August 19, 2002, this Court entered an Order granting relief from the stay and River Barge subsequently repossessed the vessels.

In the Application, River Barge and CIT now seek allowance and payment of a claim of $18,131,400.82, plus interest, as an administrative expense pursuant to 11 U.S.C. § 503(b)(1)(A), so that River Barge would be entitled to priority payment under 11 U.S.C. § 507(a)(1). River Barge and CIT assert that a "novation event" occurred when Pinnacle failed to pay an advance quarterly payment of $687,217.68 under the charter agreement which came due on July 10, 2002, after the bankruptcy was filed. River Barge and CIT contend that, as a result of the occurrence of that "novation event," a novation occurred whereby Farmland, as debtor-in-possession, automatically became bound by a new charter agreement. River Barge and CIT then assert that Farmland is liable under the new post-petition charter agreement for $18,131,400.82, including insurance premiums, storage charges, Coast Guard filing fees, and legal costs, but excluding interest and contingent claims.

In their objections, the Debtors and the Committee assert that the Novation Agreement is a pre-petition executory contract that has not been assumed by Farmland pursuant to 11 U.S.C. §

365, and therefore no new charter agreement exists and Farmland has not incurred any liability with respect to it. The Debtors and the Committee further contend that the Application should be denied because the claims of River Barge and CIT related to the unassumed Novation Agreement, if any, should be considered pre-petition unsecured claims pursuant to 11 U.S.C. § 502, not actual, necessary costs to be paid as administrative expenses pursuant to 11 U.S.C. § § 503(b)(1)(A) and 507(a)(1).

LEGAL DISCUSSION

Section 503 of the Bankruptcy Code empowers this Court to allow certain claims against Farmland's bankruptcy estates to be classified as administrative expenses. Because an administrative expense claim is elevated to first priority for payment under 11 U.S.C. § 507(a)(1), Congress included in 11 U.S.C. § 503(b) six general categories of claims that are entitled to such favored status. River Barge and CIT justify the Application using one of these six categories, 11 U.S.C. § 503(b)(1)(A), which states:

> (b) After notice and a hearing, there shall be allowed administrative expenses other than claims allowed under section 502(f) of this title, including—
>
> > (1) (A) the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case.

11 U.S.C. § 503(b)(1)(A).

"The burden of proving entitlement to an administrative expense is on the claimant and the standard of proof is a preponderance of the evidence." *In re Woodstock Assoc. I, Inc.*, 120 B.R. 436, 451 (Bankr. N.D. Ill. 1990). "Priority statutes such as § 503(b) are strictly and narrowly construed." *In re Tama Beef Packing, Inc.*, 283 B.R. 274, 276 (Bankr.N.D.Iowa 2002). A claim may be afforded administrative expense priority under § 503(b)(1) if (1) the debt arose from a transaction with the bankruptcy estate as opposed to the preceding entity; and (2) is beneficial to the estate in some demonstrable way. *See Williams v. IMC Mortgage Company* (*In re Williams*), 246 B.R. 591, 594 (8th Cir. B.A.P. 1999). *See also Tama Beef*, 283 B.R. at 276; *In re Food Barn Stores, Inc.*, 175 B.R. 723, 726 (Bankr. W.D. Mo. 1994). Administrative expense priority is afforded to those who aid in the preservation and administration of the estate or who

aid in the debtor's rehabilitation to the benefit of all creditors. *In re Jefferson Investment Co.*, 151 B.R. 920, 922 (Bankr. E.D. Mo. 1993). The benefit to the estate must be direct and substantial. *In re White Motor Corp.*, 831 F.2d 106, 110 (6th Cir. 1987).

The issues to be determined here are whether the claims asserted in the Application arose from a transaction with the bankruptcy estate and whether, assuming that the transaction was with the bankruptcy estate, the Novation Agreement provided benefit to the estate. The Court concludes that the answer is negative in both instances.

1. The claim did not arise from a transaction with the estate.

The Court finds that the claim asserted by River Barge and CIT did not arise from a transaction with the estate. The claim springs from a Novation Agreement that is a pre-petition executory contract which, as the attorney representing River Barge and CIT acknowledged in his opening statement at the hearing on this matter, "was in lieu of a guaranty" and has not been assumed by Farmland pursuant to 11 U.S.C. § 365.

The bankruptcy estate created by 11 U.S.C. § 541 includes "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). Section 541(a)(1) broadly defines property of the bankruptcy estate. *See United States v. Whiting Pools, Inc.*, 462 U.S. 198, 204-05 and n.9, 103 S.Ct. 2309, 2313-14 and n.9 (1983); *Westmoreland Human Opportunities, Inc. v. Walsh*, 246 F.3d 233, 241 (3rd Cir. 2001); *Sosne v. Reinert & Duree* (*In re Just Brakes Corp. Sys., Inc.*), 108 F.3d 881, 884 n.2 (8th Cir.), *cert. denied*, 522 U.S. 947, 118 S.Ct. 364 (1997). This broad definition "encompasses conditional, future, speculative, and equitable interests of the debtor." *United States v. Transport Administrative Services*, 260 F.3d 909, 913 (8th Cir. 2001). Pre-petition executory contracts are included in this broad definition. *See*, *e.g.*, *In re Hutchins*, 211 B.R. 325, 327 (Bankr. E.D. Ark. 1997). Under the Countryman definition, to which the legislative history of 11 U.S.C. § 365 refers and which has been employed in the Eighth Circuit, an executory contract is one where performance remains due to some extent on both sides. *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 347 (1977). *See*, *e.g.*, *In the Matter of JAS Enterprises, Inc.*, 180 B.R. 210, 215 (Bankr. D. Neb. 1995), *aff'd* 113 F.3d 1238 (8th Cir. 1997) (unpublished table decision); *Hutchins*, 211 B.R. at 327. The Novation Agreement at issue here is a pre-petition executory contract because (i) it was entered into pre-petition and (ii) performance remains due to some extent on both sides.

Pursuant to § 541, the Debtors' estates included Farmland's pre-petition rights regarding the Novation Agreement.

Section 365 of the Bankruptcy Code authorizes the trustee (and, therefore, the debtor-in-possession pursuant to 11 U.S.C. § 1107 in a Chapter 11 case) to assume or reject executory contracts. *See*, *e.g.*, *JAS Enterprises*, 180 B.R. at 217. Section 365(d)(2) provides in relevant part that "in a case under chapter … 11 … the trustee may assume or reject an executory contract … at any time before the confirmation of a plan." 11 U.S.C. § 365(d)(2). *See*, *e.g.*, *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 529, 104 S.Ct. 1188, 1198 (1984). Since the Bankruptcy Code does not impose a standard for assuming or rejecting executory contracts, courts have widely used a "business judgment test" in assessing the choices of debtors-in-possession under 11 U.S.C. § 365(a). *See*, *e.g.*, *In re Food Barn Stores, Inc.*, 107 F.3d 558, 567 (8th Cir. 1997) (noting that unless the choice is "not manifestly unreasonable or made in bad faith, the court should normally grant approval"); *Richmond Leasing Co. v. Capital Bank, N.A.*, 762 F.2d 1303, 1309-11 (5th Cir. 1985) (applying the business judgment standard to the rejection of a lease).

In this instance, the Novation Agreement was, in effect and as acknowledged by counsel for River Barge and CIT, a pre-petition guaranty by Farmland for the obligations of Pinnacle, a non-debtor. "It is not sufficient [for purposes of an administrative claim] that the payment became due after the petition date if the transaction was entered into with the debtor pre-petition." *Williams*, 246 B.R. at 594. The inclusion in the Debtors' estates of pre-petition interests in the Novation Agreement does not bind Farmland to the terms of the Novation Agreement post-petition unless Farmland, with this Court's approval, chooses to assume such an executory contract under 11 U.S.C. § 365(a). To date, Farmland has not chosen to assume the Novation Agreement. Accordingly, in the absence of the express assumption of the Novation Agreement by Farmland, subject to this Court's approval, a "novation event" could not have automatically created a new charter binding Farmland, as debtor-in-possession, or the bankruptcy estate.

River Barge and CIT have argued that Farmland "assumed the risk" that the new charter agreement could have an effective date after the bankruptcy petition date, and that a post-petition obligation might arise if novation occurred post-petition. What River Barge and CIT overlook is that they, too, assumed a risk – a risk that Farmland would file bankruptcy and that Farmland

would not assume the pre-petition contract (regardless of whether a "novation event" had or had not occurred). If there is such a thing as assumption of the risk in bankruptcy, which we consider doubtful, in this case River Barge and CIT came out on the losing side of that assumption.

River Barge and CIT cannot unilaterally and without Court approval compel the Debtor to assume an executory contract like the Novation Agreement post-petition. The Bankruptcy Code clearly states who controls the assets included in a bankruptcy estate defined by 11 U.S.C. § 541 and how and when this authority may be utilized in 11 U.S.C. § § 323, 363, 1107 and 1108. Section 1108 states that "the trustee may operate the debtor's business." Further, § 323(a) provides that "[t]he trustee in a case under this title is the representative of the estate," and § 1107 explains that "a debtor in possession shall have all the rights … and shall perform all the functions and duties…of a trustee." Accordingly, a debtor-in-possession may be the representative of an estate and operate a debtor's business. Under 11 U.S.C. § 363, only the trustee or the debtor-in-possession may enter into transactions involving property of the estate. When, as in these cases, the debtor-in-possession is managing the bankruptcy estates, entering into a contractual transaction with the debtors' estates necessarily involves the consent of the debtor-in-possession. The Bankruptcy Code does not permit an outside party to compel the trustee or debtor-in-possession to enter into a transaction on behalf of the bankruptcy estate. Moreover, assumption of an executory contract cannot be implied. *See United Food & Commercial Workers Union, Local 211 v. Family Snacks, Inc. and Official Unsecured Creditors' Committee* (*In re Family Snacks, Inc.*), 257 B.R. 884, 904 (8th Cir. B.A.P. 2001) ("As a threshold matter, we think the concept of implied assumption of an executory contract is fatally flawed...Implied assumption has no place in the law of executory contracts.").

For these reasons, the Court finds that River Barge and CIT have failed to satisfy the first element required to establish that a particular claim qualifies as an administrative expense under § 503(b)(1). Here, the claims did not arise from a transaction with the Debtors' estates, but arose from a pre-petition executory contract that has not been assumed by Farmland.

2. The Novation Agreement was not beneficial to the estate.

The Court additionally finds that the claim should be denied administrative priority status because the Novation Agreement provided no benefit whatsoever to the Debtors' estates. An

element of § 503(b)(1)(A) is that the claimed expense must result in an actual, tangible benefit to the bankruptcy estate. Incidental, potential, and indirect benefits are insufficient to support a claim. *See Williams*, 246 B.R. at 594; *In re Wedemeier*, 239 B.R. 794, 798 (8th Cir. B.A.P. 1999) (requiring a tangible benefit to the bankruptcy estate); *In re Patient Education Media, Inc.*, 221 B.R. 97, 102 (Bankr. S.D.N.Y. 1998)("Even where the debtor-in-possession possesses the nondebtor's property, or has the option to use, no administrative expense liability will attach unless he actually uses it."); *JAS Enterprises*, 180 B.R. at 217 ("[D]ecisional law makes clear that to be allowed as an administrative claim, expenses must provide tangible benefit to the bankruptcy estate; incidental benefit is not sufficient for an administrative expense."); *In re Williams*, 165 B.R. 840, 841 (Bankr. M.D.Tenn. 1993) ("Services that indirectly, incidentally, or tangentially benefit the estate do not qualify for the administrative expense priority."); *In re Conroy*, 144 B.R. 966, 969 (Bankr. W.D.Pa. 1992) ("The benefit accruing to the estate must be actual, as opposed to potential, in order for the expenditure to qualify as an administrative expense.").

Here, the Court concludes that the claim did not benefit the Debtors' estates. The estates never used the vessels and never took possession of the vessels. The Court finds that River Barge and CIT did not satisfy their burden to prove that actual, tangible benefits to the estates were established by either (i) the potential first right to use the vessels, (ii) the possibility of electing to operate the vessels to generate revenue, (iii) whether the vessels may have been built pre-petition for Pinnacle to serve Farmland, or (iv) the expenses incurred by River Barge and CIT to preserve and remarket the vessels. "The key issue is whether the transaction was beneficial to the estate[s], not whether the creditor should be compensated for a loss it incurred during the case. Incidental benefit to the estate[s]..., standing alone, is not a sufficient basis for administrative priority status." *Tama Beef*, 283 B.R. at 276 (denying administrative expense request) (internal citations omitted). *See In re Woodstock Assoc. I, Inc.*, 120 B.R. 436, 451 (Bankr. N.D. Ill. 1990)("Creditors are presumed to act primarily in their own interests and not for the benefit of the estate as a whole...and the case law is clear that '[e]fforts undertaken by a creditor solely to further his own self-interest … will not be compensable, notwithstanding any incidental benefit accruing to the bankruptcy estate.'") (internal citations omitted).

Despite their inability to prove that the barges provided a demonstrable benefit to the estate, River Barge and CIT nonetheless assert that their administrative claim should be allowed on equitable grounds. They argue that Farmland (through Pinnacle) continued to use the barges or had the right to use them, that River Barge's past and continued maintenance of the barges "*may* continue to provide an actual benefit" to Farmland's bankruptcy estate, that Farmland "*may* be planning to use" the barges to transport agricultural products, and that "*[i]t is possible*, and indeed likely, that the Barges *will become* a factor in Farmland's ongoing operations." (Suggestions in Support, p. 25) (emphasis added)[3]

For support of this proposition – that an administrative expense claim may be allowed despite the absence of any discernible benefit to the estate – River Barge and CIT point to *Reading Co. v. Brown*, 391 U.S. 471, 88 S.Ct. 1759 (1968), *Spunt v. Charlesbank Laundry, Inc.* (*In re Charlesbank Laundry, Inc.*), 755 F.2d 200 (1st Cir. 1985), and a related line of cases. However, those cases present narrow, limited exceptions to the benefit requirement of 11 U.S.C. § 503(b)(1)(A) that do not apply under the facts in this case. The *Reading* court awarded administrative expense status to the claims of parties injured by a fire caused by the bankruptcy trustee's negligence even though the bankruptcy estate did not receive any benefit from the payment of the claims. The *Charlesbank Laundry* court extended the *Reading* court's rationale to encompass post-petition fines occasioned by a debtor-in-possession's intentional disregard of a state court's order enjoining local zoning ordinance violations. In *Reading* and *Charlesbank Laundry* the events giving rise to administrative expense status occurred post-petition, which is not the situation in this case. Nor did those cases involve pre-petition contracts or agreements, such as we have here. Thus, the *Reading* and *Charlesbank Laundry* cases are inapplicable.

Moreover, River Barge's and CIT's arguments are sheer speculation, totally unsupported by any facts or evidence. There has been no showing that Farmland used the barges or that it might use them in the future; in fact, Farmland disclaimed any interest in any possible use of the barges, now or in the future.

In sum, because River Barge and CIT have failed to prove that the expenses set forth in the Application arose from a transaction with the estate or that the expenses incurred benefitted

[3] The argument as to possible future use of the barges by Farmland is especially curious in view of the fact that River Barge and CIT have, with the Court's permission and Farmland's acquiescence, repossessed all of the barges.

the Debtors' estates in some demonstrable way, the Court denies their request for administrative expense priority status.

Therefore, it is

ORDERED that the Joint Application for Allowance and Payment of Administrative Expense Claim Pursuant to Section 503(b) of the Bankruptcy Code filed by River Barge Partners, L.P. and The CIT Group/Equipment Financing, Inc. is hereby DENIED (i) with prejudice with respect to an administrative expense request pursuant to 11 U.S.C. § 503 unless and until the Debtors assume the Novation Agreement and (ii) without prejudice with respect to a possible claim pursuant to 11 U.S.C. § 502.

SO ORDERED this 16th day of April, 2003.

/s/ Jerry W. Venters
United States Bankruptcy Judge

All parties served electronically.